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IN THE

SUPREME COURT of the UNITED STATES

OCTOBER TERM, 1978

No. 78-1775
No. 78-1776

JOSEPH A. SCHAFER, et al.,
DR. ROBIN S. KEY,
Petitioners

v.

THE PENN CENTRAL CORPORATION,
PENN CENTRAL COMPANY, et al.,
Respondents

On Petitions for Writs of Certiorari to the
United States Court of Appeals
for the Third Circuit

BRIEF IN OPPOSITION FOR THE PENN CENTRAL CORPORATION AND PENN CENTRAL COMPANY

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OPINIONS BELOW

The judgments and opinion of the Court of Appeals are found in Petitioners' Appendix at pages A.1-36. The opinion of the Court of Appeals is not yet reported. The opinion of the Reorganization Court approving the Plan of Reorganization for Penn Central

Transportation Company (PCTC Plan) is reported at 458 F. Supp. 1234 and is found, in part, in the Appendix at pages A. 134-216. The Reorganization Court's opinion accompanying its order confirming the PCTC Plan is reported at 458 F.Supp. 1364 and is found, in part, in the Appendix at pages A. 107-130.

The order of the PCC Chapter XI Court confirming the PCC Plan of Arrangement is found in the Appendix at pages A. 46-48. The District Court's order affirming the confirmation of the PCC Plan of Arrangement is reproduced in the Appendix at page A. 44. The Court of Appeals has before it, but has not yet decided, Petitioner Key's appeal (C-A. No. 79-1573) from an order of the Chapter XI Court dismissing Key's complaint.[1]

QUESTIONS PRESENTED

1. Do Petitioners, who were stockholders of Penn Central Company, the sole stockholder of Penn Central Transportation Company, and whose appeals from orders relating to the PCTC Plan were dismissed for lack of standing, have standing to seek a review of the decisions below?

2. Assuming *arguendo* that Petitioners have standing, is there any basis for reviewing the decision

1. Dr. Key's Petition, insofar as it asks this Court to consider an appeal prior to judgment in the Court of Appeals, can be dismissed summarily. His case, which simply renews and embellishes the arguments made by Schafer, et al. in the PCC proceedings, clearly is not a case of imperative public importance that requires immediate resolution in this Court pursuant to Rule 20. *Cf.* New Haven Inclusion Cases, 399 U.S. 392 (1970); United States v. Nixon, 418 U.S. 683 (1974).

of the Court of Appeals that the PCTC Plan, which was approved and confirmed and which has been successfully consummated, made adequate provisions for Penn Central Company?

3. Did the court below properly determine that nothing in the United States Constitution, the Bankruptcy Act, or the Pennsylvania Business Corporation Law prohibited the duly elected directors of Penn Central Company from consenting to the PCTC Plan or from negotiating Penn Central Company's own plan of arrangement without vote of or individual written notice to its shareholders?

COUNTERSTATEMENT OF THE CASE

Petitioners, Joseph A. Schafer, et al. and Dr. Robin Key, are nine of approximately 150,000 former stockholders of Respondent, Penn Central Company (PCC), which, prior to the consummation on October 24, 1978 of the PCTC Plan under section 77 of the Bankruptcy Act, was the sole stockholder of Penn Central Transportation Company (PCTC or Debtor). PCC has itself been in reorganization under Chapter XI of the Bankruptcy Act. Respondent, The Penn Central Corporation (Penn Central), is the reorganized PCTC and successor to the Trustees of the property of PCTC (Trustees).

The PCC stockholders' petitions for writs of certiorari ask this Court to review the decisions of the United States Court of Appeals for the Third Circuit (A. 8-10, 13-36[2]) which: (1) dismissed for lack of standing the

2. References made herein to "A. " are to the Appendix to the stockholders' Petitions.

stockholders' appeals from orders of the United States District Court for the Eastern District of Pennsylvania (Reorganization Court) approving (Approval Order),[3] confirming[4] and directing the consummation of the PCTC Plan; and (2) affirmed decisions of the United States District Court for the Eastern District of Pennsylvania supervising PCC's reorganization proceedings under Chapter XI which confirmed PCC's Plan of Arrangement and dismissed an adversary complaint filed by Petitioners against PCC.

The Court of Appeals dismissed each of Petitioners' appeals relating to the PCTC Plan on the grounds that, as stockholders of PCC, the sole stockholder of PCTC, they lacked standing (a) to be heard in the Reorganization Court under Section 77(c)(13) of the Bankruptcy Act and (b) to appeal orders of the Reorganization Court. (A. 9-10, 13-36) Notwithstanding the dismissal of Petitioners' appeals for lack of standing, the Court of Appeals considered and rejected the merits of Petitioners' objection that the provisions of the PCTC Plan for the participation of PCC, as stockholder, were not fair and equitable. (A. 23-30) The Court also concluded that the PCC Plan of Arrangement did not require stockholder approval and did not overcompensate PCC's creditors. (A. 31-36)

The Reorganization Court's comprehensive opinions approving and confirming the PCTC Plan (A. 137-216, 99-130) and the opinion of the Court of Appeals

3. In re Penn Central Transportation Co., 458 F. Supp. 1234 (E.D. Pa. 1978).

4. The opinion of the Reorganization Court accompanying the confirmation and consummation orders is reported in: In re Penn Central Transportation Co., 458 F. Supp. 1364 (E.D. Pa. 1978).

(A. 13-36) thoroughly considered the basis of PCC's participation under the PCTC Plan in the context of the massive administration, secured and unsecured claims against PCTC and the overriding uncertainties concerning the value and availability of the Debtor's assets to satisfy such claims. Rather than to attempt to repeat all of those facts here, Penn Central and PCC respectfully refer the Court to the opinions below and will review only the salient features of the PCTC Plan and the PCC Plan of Arrangement affecting the treatment of PCC and its stockholders.

Under the PCTC Plan, PCC, as stockholder of PCTC, received 10% of the common stock of the reorganized PCTC. Pursuant to PCC's Plan of Arrangement, its stockholders received 40% of the stock of Penn Central distributed to PCC, or 4% of the common stock of Penn Central. The remaining 60% of the Penn Central stock received by PCC, or 6% of the total amount of common stock, was distributed to holders of Swiss franc notes issued by PCC who asserted a claim against PCC in excess of $150 million. That claim was secured by a pledge of 35% of PCC's stock holdings in PCTC.

As the Court of Appeals noted, PCC's participation in the PCTC Plan resulted from a basic assumption that the PCTC estate was solvent. (A. 17) This assumption, in turn, was necessarily based on the probability that the eventual outcome of the proceedings in the Special Court established under the Regional Rail Reorganization Act of 1973, 45 U.S.C. §§701-794 (Rail Act), to determine the value of the PCTC rail assets conveyed under the Rail Act (Valuation Case) would

yield a recovery sufficient to satisfy the claims of all the creditors and claimants of PCTC whose interests were superior to that of the stockholder. The Court of Appeals recognized, however, as the Reorganization Court stated in its Approval Opinion, that "if the Valuation Case should produce a very small recovery, the assumption of solvency would be incorrect." 458 F. Supp. at 1255. (A. 165)

The PCTC Plan resolved, through a series of compromises, the pervasive uncertainties concerning the value of PCTC's principal asset—its properties conveyed under the Rail Act—by according, to all but the very senior administration claimants, securities and stock whose value will ultimately be determined in whole or in part by the Valuation Case recovery. Thus, nearly all claimants, including PCC and its stockholders, stand to recover more or less than they might have otherwise if all of the assets of the Debtor could have been easily valued and made readily available for distribution. On the other hand, by offering an opportunity to participate in the reorganized PCTC prior to the expected conclusion of the Valuation Case in 1987, the PCTC Plan assured for all classes of participants, including PCC and its stockholders, some recovery realizable before the conclusion of the Valuation Case.

Following discussions and negotiations with various claimants in the PCTC proceedings concerning the interest, if any, to be accorded PCC under the PCTC Plan, PCC concluded that the PCTC Plan was fair and sought and obtained authorization from its Chapter XI

Court to support and vote to accept the PCTC Plan.[5] Notwithstanding PCC's vote in favor of the PCTC Plan, Petitioner Schafer and a few other individual stockholders of PCC objected to the approval of the PCTC Plan on the grounds that it was not fair and equitable to PCC. After a thorough analysis of the PCTC Plan and of the very extensive record before it, the Reorganization Court concluded that

> "[t]he Trustees' proposal to permit equity interests to participate is reasonable and should be approved. Conversely, however, I am also persuaded that no greater participation than the Plan provides can be justified on the present record." 458 F. Supp. at 1343. (A. 213)

Petitioners later objected to the confirmation and consummation of the PCTC Plan, again on the grounds that it was not fair and equitable to PCC, and asserted that the vote of PCC in favor of the PCTC Plan was invalid. The Reorganization Court held that the objection must be denied for the reasons that "he [was] not a shareholder of the Debtor as required by §77(c)(13)." (A. 116) The Reorganization Court concluded that "the Plan's treatment of the Debtor's stock interest is fair and equitable." 458 F. Supp. 1371. (A. 121) In confirming the PCTC Plan, the Reorganization

5. PCC's motion for summary judgment on the stockholders' adversary complaint (which Petitioners omitted from their Appendix) showed by uncontested affidavits that the trustee for PCC's principal creditors—the holders of notes payable in Swiss francs in amounts in excess of $150 million—would have withheld the essential consent of those noteholders to PCC's Plan of Arrangement if PCC had risked the loss of the distribution of 10% of the new stock of the reorganized PCTC by failing to approve the PCTC Plan.

Court accepted as valid PCC's vote, but stated that, even if the vote could not have been considered valid, it would have exercised its "cramdown" power under section 77(e) of the Bankruptcy Act to confirm the PCTC Plan notwithstanding the absence of a valid acceptance by the stockholder. 458 F. Supp. at 1373. (A. 122)

Petitioners requested the Reorganization Court to stay the consummation of the PCTC Plan pending their appeal from the Approval Order and the conclusion of the Valuation Case. The Reorganization Court denied the request, stating:

> "Their standing in these proceedings is so dubious, and the merits of their arguments so tenuous, that the pendency of their appeal plainly does not justify delaying consummation." 458 F. Supp. at 1376. (A. 127)

Petitioners then sought a stay of the consummation in the Court of Appeals, which denied the request on October 17, 1978. (A. 42-43) On October 23, 1978, on the eve of the scheduled consummation of the PCTC Plan, Petitioners sought a stay from Mr. Justice Brennan, who denied the request the same day. (A. 41) Petitioners' second request for a stay, addressed to the Chief Justice and referred to the Court, was denied on November 13, 1978. (A. 40)

In its opinion of January 11, 1979, the Court of Appeals, after concluding that Petitioners lacked standing to appeal, rejected their assertions that the PCTC Plan did not provide fair and equitable consideration for the interest of PCC. The court below held that "the reorganization court exercised sound judgment in

concluding that the Plan provides fair treatment and compensation to the PCC." (A. 30) In addition, the Court of Appeals rejected Petitioners' argument that the combination of the PCTC Plan and the PCC Plan of Arrangement resulted in a deprivation of the stockholders' property rights under the Fifth Amendment. It held that "if . . . both the reorganization plan and the arrangement meet the requirements of Section 77 and Chapter XI respectively, no constitutional violation would exist." (A. 30-31)

Finally, the Court of Appeals analyzed the impact of the PCC arrangement proceedings on PCC shareholders and concluded that the satisfaction of the Swiss franc debt of over $150 million for 60% of PCC's shares in the reorganized PCTC did not over-compensate the noteholders. (A. 35) Accordingly, it affirmed the order confirming PCC's Plan of Arrangement.

Petitioners filed a motion for rehearing *en banc*. By order dated February 28, 1979, the Court of Appeals denied the motion. (A. 3-4) The stockholders then filed their Petitions for writs of certiorari on May 29, 1979.

REASONS FOR DENYING THE WRIT

I. Petitioners Lack Standing To Seek a Review of The Decisions Below as They Apply to the PCTC Reorganization.

Petitioners do not challenge the decision of the court below that they lacked standing to appeal under Section 77(c)(13) and Bankruptcy Rule 8-210. In the absence of any challenge to the decision on standing,

their Petitions may be denied without further consideration.

The Court of Appeals' concluded that, since Petitioners were stockholders of PCC, not of PCTC, they lacked standing to appeal orders of the Reorganization Court. This decision reaffirmed its earlier holding in *In re Penn Central Transportation Co.*, 455 F.2d 811 (3d Cir.), *cert. denied*, 407 U.S. 915 (1972). There, it was held that "the standing of a participant to a railroad reorganization to appeal from an order of the reorganization court turns on whether section 77(c)(13) of the Bankruptcy Act, 11 U.S.C. §205(c)(13) (1964), grants him a right to be heard." 455 F.2d at 815. The stockholders of PCC clearly did not fall within the class of persons having the right to be heard under section 77(c)(13), which provides that

> "the debtor, any creditor or stockholder, or the duly authorized committee, attorney or agent of either or the trustees or trustees of any mortgage, deed of trust or indenture pursuant to which securities of the debtor are outstanding shall have the right to be heard on all questions in the proceedings." 11 U.S.C. §205(c)(13).

Bankruptcy Rule 8-210 contains similar provisions:

> (a) *Standing to be Heard.*
>
> (1) The debtor, the indenture trustees, and any creditor or stockholder of the debtor shall have the right to be heard on all matters arising in a Chapter VIII case.

Petitioners' interests in the PCTC reorganization proceedings were merely derivative of the interest of PCC, as stockholder of the Debtor, and were fully and adequately protected by PCC. For this reason, the courts below had earlier denied attempts by stockholders of PCC to intervene in the PCTC proceedings. *In re Penn Central Transportation Co.*, 454 F.2d 710 (3d Cir.), *cert. denied*, 406 U.S. 944 (1972); *In re Penn Central Transportation Co.*, 328 F. Supp. 1273 (E.D. Pa. 1971), *aff'd per curiam*, 455 F.2d 976 (3d Cir. 1972).

The fact that some of the Petitioners and other individual stockholders of PCC were permitted by the Reorganization Court to appear and file objections to the PCTC Plan did not confer upon them the status of parties or accord the stockholders of PCC the right to be heard in the PCTC proceedings. *In re Penn Central Transportation Co.*, 455 F.2d at 815, n.11; *Peckham v. Casalduc*, 261 F.2d 120 (1st Cir. 1958), *cert. denied*, 359 U.S. 958 (1959).

Although Petitioners blithely ignore their lack of standing below, they suggest that the decision in *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1970), mandates that, under the peculiar circumstances of this case, they should be accorded appellate rights. The argument reveals that the issue is unique to this proceeding, but in any event *Mullane* has no relevance to the question of standing. That case dealt with the adequacy of notice to parties to a judicial settlement of a common trust fund and held that notice by publication in a local paper was inadequate for beneficiaries of the fund whose addresses were known and for whom notice by mail was not impracticable. It in no

way suggests that appellate rights must be given to the stockholders of the stockholder of the Debtor, where the stockholder itself, PCC, was a party which could have appealed and has adequately represented their interests. (A. 19-20)

II. Petitioners Had No Right to Individual Notice of Hearings In the Reorganization Court or Chapter XI Court.

Petitioners argue that *Mullane* suggests that the failure to give notice by mail of the hearings in the PCTC reorganization proceedings and hearings relating to the PCC Plan of Arrangement to each of the 150,000 stockholders of PCC was a violation of due process.

Mullane differs from the present case in two crucial aspects. First, it involved a judicial proceeding to settle the accounts of a trust fund which would have the effect of absolving the trustee of any liability for negligent or illegal impairments of the trust. Second, the property interest involved was the vested interest of the beneficiaries in the specific identifiable property which constituted the trust corpus. By contrast, in the present case the directors of PCC and the PCTC Trustees both were subject to court supervision and court orders and no question of impairment of any asset is present. More importantly, the dispute in this case does not concern specific identifiable property in which the stockholders of PCC had a vested interest; rather, Petitioners allege an interest in the unpredictable recovery from the Valuation Case. Indeed, as the record shows and the courts below found, there is a serious question whether the stockholders of PCC would recover anything after the payment of creditors if they awaited the outcome of the Valuation Case.

Equally important, the board of directors of PCC, unlike the guardian in *Mullane*, was elected by the stockholders themselves (except for one elected according to law as a replacement by the remaining directors). In fact, the stockholders could have called a meeting and removed the directors had they felt that the directors did not adequately represent the stockholders interests. Thus, the stockholders had not only picked their representatives in this case, but had a working control over them.

The provisions of Chapter XI of the Bankruptcy Act, 11 U.S.C. §§701-799, confirm the lack of merit in Petitioners' arguments. Chapter XI provides for a negotiation between a debtor (which may be a corporation) and its creditors of a plan for division of its assets in a way that will achieve the consent of a majority in number and amount of its classes of creditors to the modification or cancellation of their original claims. A plan may be filed *only* by the *debtor*, and a vote of its stockholders is accordingly not required by Chapter XI.

For appropriate action to formulate such a plan, one must look to the law governing the debtor corporation, here the Pennsylvania Business Corporation Law (BCL). Section 401 of the BCL, 15 Pa. Stat. Ann. §1401, provides that "the business and affairs of every business corporation shall be managed by a board of directors . . ." There is no provision in the BCL for submission of a proposed plan or plans to the stockholders. Moreover, once a plan is negotiated by the board with

creditors, filed by the board, properly accepted by the creditors and confirmed by the court, Section 320 of the BCL, 15 Pa. Stat. Ann. §1320(1) (A. 33), expressly permits a reorganization or arrangement under the Bankruptcy Act so confirmed by a court of competent jurisdiction to be put into effect without further action by the corporation's directors or stockholders.

Petitioners carefully omit to claim that they lacked actual notice of the proceedings. In fact, any claim by Petitioners that they lacked actual notice would be incredible. The highly publicized PCTC reorganization proceedings have been ongoing since 1970. Rather, they make the abstract assertion that they had a due process right to individual mailed notice, regardless of actual notice. A similar argument, based on *Mullane*, was rejected in *Bank of Commerce v. Board of Governors of Federal Reserve System*, 513 F.2d 164, 167 (10th Cir. 1975).

Moreover, each of the courts below, despite determining that the stockholders of PCC lacked standing, heard such stockholders as chose to participate and ruled on their contentions on the merits, finding in each case that the actions of the PCC directors were proper. Where the charge of an erroneous deprivation of Petitioners' property interest was actually heard and determined not to exist, no due process violation can be established. *See Carey v. Piphus*, 435 U.S. 247, 259 (1978). It was only after considering the stockholders' arguments that the Reorganization Court found that the PCTC Plan was fair and equitable to PCC under Section 77(e) of the Bankruptcy Act and that the Court of Appeals found that the PCC stockholders were not

prejudiced by the PCC Plan of Arrangement. (A. 30-31)

III. Petitioners' Challenge to the PCTC Plan Is, in Any Event, Without Substance.

Although the PCTC and PCC reorganization proceedings were large and complex, the case presented by Petitioners is simply not one that falls within the scope of this Court's Rule 19(b). There is no conflict between the decision of the court below and decisions of this Court or other courts of appeals. The statutes involved and the principles applied by the courts below are clear and unambiguous. Moreover, the provisions of the Bankruptcy Act in question have been repealed.

Petitioners' complaint on the merits is that the provision of the PCTC Plan which accorded to PCC, as the stockholder of the Debtor, 10% of the common stock of the reorganized company is unfair and inequitable. The issue was carefully canvassed by the Reorganization Court, 458 F. Supp. at 1343 (A. 212-13), and was accepted by the court below. The participation by PCC in the PCTC Plan was based on the assumption that the estate was solvent. The possibility of an enormous recovery in the Valuation Case, to which Petitioners allude, is tempered by the possibility that the recovery would not be large enough to render the estate solvent, in which case PCC would have been entitled to nothing. *Ecker v. Western Pac. R.R.*, 318 U.S. 448 (1943). The compromise of the issue by according PCC 10% of the common stock was agreeable to PCC and was accepted by the court below. Similarly, as the Court of Appeals

noted, the distribution to the PCC stockholders of the stock received by PCC was, by any reasonable measure, eminently reasonable. The suggestion (Schafer Pet. at pp. 17-18) that this Court should again review this issue in order to satisfy the PCC stockholders that justice had been done misconceives the function of this Court and plainly ignores the fact that the nine Petitioners appear to be the only PCC stockholders who reject the PCTC Plan and the PCC Plan of Arrangement.

Petitioners' further assertion that the court below should have provided the PCC stockholders with a contingent interest in the Valuation Case (Schafer Pet. at p. 19) also fails to establish a basis for granting their Petitions. The question before the Court of Appeals was whether the PCTC Plan was fair and equitable, not whether some vaguely defined alternative, which would have repercussions with respect to the treatment of all classes of creditors, should have been incorporated. *Ecker v. Western Pac. R.R., supra*, at 475-76.

A greater or different participation by the stockholder would have involved the compromise of the interest of the secured and unsecured creditors whose claims could not be satisfied by PCTC's retained assets alone. The Reorganization Court properly approved the Trustees' judgment, which was concurred in by PCC, that PCC's 10% equity participation in the reorganized PCTC was not only a reasonable compromise of the issue, but also fair and equitable. Those judgments were correctly endorsed by the Court of Appeals below. *Protective Committee for Independent Stock-*

holders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414 (1968).

Finally, it may be appropriate to respond to Petitioners' contention (Schafer Pet. at p. 19) that the PCTC Plan puts the creditors in control of a possible settlement of the Valuation Case, with the possibility that there will be no proceeds in excess of the creditors' claims. The creditors, of course, hold 90% of the common stock of Penn Central, and it is obviously in their interest to obtain the greatest possible Valuation Case recovery, which will equally benefit the 10% of the common stock allocated to PCC. The interests of the creditors and of the former stockholders are common, not conflicting.

CONCLUSION

With respect to the PCTC reorganization, Petitioners lack standing to ask the Court to review these matters. Even if Petitioners had the requisite standing, however, they raise no issue of general importance and no basis is shown for this Court to re-examine the PCTC Plan, which has been approved by the courts below and successfully consummated.

Similarly, the challenge to the PCC Plan of Arrangement raises no issue of general importance and shows no reason to disturb the completed arrangement approved by the courts below.

The Petitions should be denied.

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